



**The BAA Pension Scheme**  
**Report & Accounts**  
**for the year ended 30 September 2017**

## **Report and Accounts for the year ended 30 September 2017**

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Any enquiries regarding the Scheme generally or in relation to an individual's entitlement to benefits should be addressed to:

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## BAA Pension Scheme Trustee's Report

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### THE BAA PENSION SCHEME

The BAA Pension Scheme ("the Scheme") was established in April 1966. It is a contributory, final salary, defined benefit arrangement. The Scheme includes the transferred assets and liabilities of the BAA Group Pension Scheme established 1 January 1991 and wound up 30 June 1996.

The Scheme was closed to new entrants with effect from 14 June 2008.

The Scheme is established under irrevocable trusts and administered by the Trustee in accordance with the provisions of the Trust Deed and Rules which are amended from time to time. The Principal Employer is LHR Airports Limited ("the Employer") and the primary purpose of the Scheme is to provide pensions on retirement and other benefits for all eligible participants.

### 1. TRUSTEE AND ADVISERS

The Trustee is BAA Pension Trust Company Limited, and it is responsible for the management of the Scheme. Law Debenture Pension Trust Corporation (LDPTC), although not formally a trustee is referred to in the Rules as the Independent Trustee and has special reserve powers designed to safeguard the accrued rights of beneficiaries. LDPTC satisfies requirements of independence from the Employer set out in the Trust Deed and Rules. LDPTC's nominated representatives, who attend Trustee meetings, are Messrs M Chatterton or M Jaffe.

The Trustee is responsible for all aspects of the Scheme. However, in order to facilitate the efficient discharge of business certain matters are, from time to time, delegated to and managed by an investment committee or other specialist committees. Any decisions of the committees are subject to endorsement by the full Trustee Board, except where this is not appropriate, e.g. where doing so would create a "conflict of interest".

Details of the Directors of the Trustee Company ("the Trustee Directors") and its advisers, who served during the year, are set out below:

#### **BAA Pension Trust Company Limited**

Unless otherwise stated, the Trustee Directors are Management Representatives

##### **Trustee Directors**

P Wilbraham *β	Chairman
S Chambers *+β	(Member Nominated Trustee Representative)
A Hurn *β	
M Macgregor #+	(Pensioner Nominated Trustee Representative)
A Macmillan*	
D Provan #	(Member Nominated Trustee Representative - Resigned 31 January 2017)
P Stannett #	
P Williams #	(Member Nominated Trustee Representative)

##### **Independent Trustee**

\*+β Mr M Chatterton (LDPTC)  
 \*+β Mr M Jaffe ( LDPTC)

##### **Secretary to the Trustee**

#\*+β Mr A Knowles

+ member of the Audit and Risk Committee

\* member of the Investment Committee

# member of the Administration Committee

β member of the Valuation Committee

**BAA Pension Scheme  
Trustee's Report**

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**ADVISERS**

<b>Actuary</b>	C Sheppard FIA, Mercer Limited
<b>Auditor</b>	Crowe Clark Whitehill LLP
<b>Administrators</b>	Equiniti Paymaster
<b>Bankers</b>	Lloyds Bank plc
<b>Custodian</b>	JP Morgan Chase. Assets are held in the name of 'Chase Nominees'.
<b>Investment Managers</b>	BlackRock Investment Management (UK) Limited BlueBay Asset Management LLP Brevan Howard Fund Ltd (until December 2017) Bridgewater Associates LP (from November 2017) Invesco Asset Management Ltd M&G Asset Management Man Group plc (from November 2017) Rogge Investment Management State Street Global Advisors Ltd Wellington Asset Management Winton Capital Management Ltd (until November 2017)
<b>Investment Consultants</b>	Cardano (until March 2017) Redington (from April 2017)
<b>Legal Adviser</b>	CMS Cameron McKenna Nabarro Olswang LLP

## BAA Pension Scheme Trustee's Report

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### 1. TRUSTEE AND ADVISERS (continued)

#### **Procedure for Appointment and Removal of Trustee Directors of BAA Pension Trust Company Limited**

The approved arrangements for this Scheme, which comply with the requirements specified in the Pension Act 2004, are summarised as follows:

Trustee Directors are appointed by the Board of the Employer and will normally serve a three year term. There shall be eight Trustee Directors: four Management Representatives, three Members' Representatives and one Pensioner Representative. At 30 September 2017 there was one Trustee Director vacancy on the Board. The appointment of the Chairman and Management Representatives is based on nominations made by the Employer. The Members' and Pensioner Representatives are chosen by ballot controlled by the Electoral Reform Society.

A Trustee Director may also be removed at his/her own or at the Employer's request and any Trustee Director who fails to attend any Trustee meeting in a six month period may be removed from office by the Employer at the request of the other Trustee Directors. Where the Trustee Director being removed was a Member or Pensioner representative, all the other Trustee Directors must agree to the removal and elections would then be held to appoint a replacement.

#### **Procedure for Appointment and Removal of the Independent Trustee**

There must at all times be a single Independent Trustee of the Scheme. It is appointed by and can be removed by the Employer in certain circumstances or may, at its own request, retire. A replacement Independent Trustee would have to be appointed simultaneously with any removal or resignation and the outgoing Independent Trustee would be entitled to write to all beneficiaries explaining the circumstances of its replacement, removal or resignation.

#### **Investment Committee**

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would make operational decisions relating to the implementation of the Scheme's investment strategy including selection and appointment of investment managers.

#### **Valuation Committee**

The membership of the Committee is noted on page 1. The Trustee decided that this group will be an ad hoc committee which would only deal with the issues relating to the triennial actuarial valuation, including dialogue with the Company and preparation of valuation related correspondence for the Main Board.

#### **Audit and Risk Committee**

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would be responsible for dealing with any issues relating to the preparation and audit of the statutory accounts, monitoring the Scheme's internal controls and record keeping, and maintenance of the Risk Register of the Scheme.

#### **Administration Committee**

The membership of the Committee is noted on page 1. The Trustee decided that this group will be a standing committee which would be responsible for monitoring the third party administration services provided by Equiniti Paymaster and make delegated day to day decisions concerning settlement of death benefits and other discretionary benefits.

#### **Trustee Training**

All newly appointed Trustee Directors are required to attend suitable training. During their term of office or on reappointment, Trustee Directors are encouraged to identify their own training needs and attend appropriate courses. In addition a formal half day's training is organised every November.

The Pensions Regulator has issued scope guidance specifying the expected knowledge and understanding requirements of a competent trustee. Each Trustee Director attends appropriate training so they become conversant with Scheme documents and develop knowledge and understanding (appropriate to their role as Trustee Director) of trusts and pensions law and the principles of funding and investment.

## **2. CHANGES DURING THE YEAR**

### **Investment Manager Changes**

In August 2016, the Trustee instructed a full redemption from Brevan Howard, due to disappointing performance, with redemption proceeds to be received in four quarterly installments, starting on 31 March 2017. As such, installments of c.£29m were received at the end of March, June, September and December 2017. These proceeds were received into the JP Morgan liquidity fund and were subsequently transferred into the LDI portfolio managed by BlackRock.

A number of smaller changes were made to the Rogge and Wellington mandates to increase expected returns whilst reducing fees. Changes were also made to the BlackRock LDI mandate to future proof the LDI portfolio and increase its efficiency. These changes are detailed further in section 12 – Investment Strategy.

## **3. CHANGES AFTER YEAR-END**

During 2017, the Scheme conducted a review of the strategic asset allocation and, at the June ISC meeting, decided to implement the asset allocation detailed below:

- Invest 10% of assets in Diversified Risk Premia (DRP), to be funded using the disinvestment proceeds from Brevan Howard (2%), full disinvestment from Winton (6%) and reduction in the allocation to Invesco (2%). The rationale for this change was to target a higher expected return whilst increasing diversification and capital efficiency, and reduce reliance on manager skill by allocating toward more systematic strategies.
- Invest 4% in Opportunistic Illiquid Credit (OIC) and 4% in Diversified Matching Illiquids (DMI) to be funded by fully disinvesting from Rogge (8%). The rationale for this change is to increase the expected return further by harnessing illiquidity premia and increase running yield through a higher allocation to credit-based strategies.

A decision was subsequently made at the September ISC meeting to appoint two new DRP fund managers, Man Group plc and Bridgewater Associates LP. The transition into DRP was implemented shortly after year end, in the week between 31 October and 6 November 2017. Investment in OIC commenced in the first quarter of 2018.

In addition, the BlueBay mandate is currently in the process of being transitioned from a pooled to a segregated structure to benefit from a preferential fee rate and reduced operational costs. The transition was completed during the first quarter of 2018.

## **4. MEMBERSHIP OF THE SCHEME AND PENSIONERS**

	<b>30 September 2017</b>	<b>30 September 2016</b>
(a) Active Members	3,147	3,366
(b) Pensioners		
Former Members	7,217	7,148
Dependants	1,733	1,753
(c) Deferred Pensioners	5,027	5,127
Total	17,124	17,394

## **5. ACTUARIAL VALUATION AND CONTRIBUTIONS**

The Trustee undertakes a full valuation at least every three years in line with the requirements of the Pensions Act 2004. A full valuation of the BAA Pension Scheme was carried out as at 30 September 2015 and determined a shortfall of £228m (equal to a funding level of 94%).

The 2015 valuation was the fourth valuation for the Scheme under the Pensions Act 2004 and the Scheme Funding Regulations issued in 2005 which require schemes to adopt the Statutory Funding Objective. The Trustee decided on a funding objective, including a set of actuarial assumptions, and agreed it with the Employer. This is set out in the current Statement of Funding Principles.

The Trustee and Employer agreed a Recovery Plan that sets out how the shortfall of £228m as at 30 September 2015 is to be addressed. The Trustee and Employer agreed that £27m p.a. (payable monthly) would be paid into the Scheme until 30 June 2016 followed by £23m p.a. paid monthly from 1 July 2016 to 30 September 2022. At the end of this Recovery Plan period, the shortfall is expected to be eliminated. The Recovery Plan will be reviewed, and may be revised, as part of the Scheme's next valuation due as at 30 September 2018.

As a result of the 2015 valuation, the Trustee and Employer agreed that regular Employer contributions of 23.0% of Basic Salary plus Shift Pay would be paid from 1 July 2016, a reduction from 33.3% payable up to 30 June 2016, in addition to the deficit reduction contributions of £23m p.a., to meet the cost of the future accrual of benefits. Employee contributions continued to be payable at between 5% and 7.5% of Pensionable Salary, however, from 1 October 2015, Pensionable Salary increases were capped at 2% p.a.

The Employer also continues to pay the augmentation costs (if any) arising following redundancies.

The level of contributions paid by members of the Scheme is set out in the Schedule of Contributions and Trust Deed and Rules of the Scheme. A revised Schedule of Contributions was agreed by the Employer and the Trustee during the year, effective from 1 July 2016, which set out the changes to contributions due to the Scheme as detailed above.

Employees' and Employers' contributions are due monthly by the 19<sup>th</sup> day of the following month to which contributions relate. Contributions relating to benefit augmentations are due within one month of the later of the date of granting of the augmentation or such later date as is agreed between the Trustee and the Employer.

### ***Report on Actuarial liabilities***

Under section 222 of the Pensions Act 2004, every scheme is subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions, which represent the present value of benefits to which members are entitled based on pensionable service to the valuation date. This is assessed using the assumptions agreed between the Trustee and the employer and set out in the Statement of Funding Principles, a copy of which is available to Scheme members on request.

The most recent actuarial valuation of the Scheme was carried out as at 30 September 2015. A summary of the funding position at the valuation date is set out below:

	<b>Funding Assessment as at 30 September 2015 £m</b>	<b>Funding Assessment as at 30 September 2013 £m</b>
Market value of assets	3,316.2	£2,836.5
Technical provision liabilities	3,544.3	£3,136.4
Deficit	(228.1)	(299.9)
Funding Level	94%	90%

Method: The actuarial method used in the calculation of the technical provisions is the Attain Age method.

The key assumptions underlying the calculation of technical provisions were:

Retail Price Inflation	3.29% p.a.
Consumer Price Inflation	2.54% p.a.
Pensionable salary increases	
• Scale/ negotiated grade employees	1.90% p.a.
• Non-scale/ management grade employees	1.90% p.a.
Basic Salary plus Shift Pay increases	
• Scale/ negotiated grade employees	4.79% p.a.
• Non-scale/ management grade employees	4.79% p.a.
Discount rate:	
Pre-retirement	4.11% p.a.
Post-retirement	2.91% p.a.
Pension increases in payment:	
Open section	3.19% p.a.
Closed section	3.29% p.a.
Post 2015 pension	2.29% p.a.
Mortality – base table	103% of S2PA year of birth tables for males and 95% of S2PA year of birth tables for females to reflect the membership profile of the Scheme.

The Actuary's annual funding update as at 30 September 2016 showed that the deficit had increased from £228.1m as at 30 September 2015 to an estimated £269m with the value of assets being 94% of the amount needed to cover the Scheme liabilities on a technical provisions basis.

The next formal actuarial valuation is due as at 30 September 2018.



## BAA Pension Scheme Trustee's Report

### 6. FINANCIAL DEVELOPMENT OF THE SCHEME

The financial statements have been prepared and audited in accordance with regulations made under Section 41(1) and (6) of The Pensions Act 1995. The Fund Account shows in detail the financial development of the assets of the Scheme over the year to 30 September 2017.

A summary of the changes in the Scheme during the year and in the preceding year were as follows:

	Year to 30 September 2017 £'000	Year to 30 September 2016 £'000
Income	56,515	70,113
Expenditure	(120,795)	(106,781)
Net withdrawals	(64,280)	(36,668)
Net return from investments	(80,598)	762,705
Net (decrease)/ increase	(144,878)	726,037
Net assets at beginning of year	4,063,556	3,337,519
<b>Net assets at end of year</b>	<b>3,918,678</b>	<b>4,063,556</b>

### 7. PENSION INCREASES

Although the two original schemes have been merged, pension increases are still determined relative to the category of membership basis.

Both the "Plc Section" basis and the "Group Section" basis are determined in accordance with the relevant version of the Trust Deed and Rules (as amended) that applies to particular members. Under the version of the Rules in place as at 30 September 2015, pensions are increased with effect from 1 October in line with the proportionate increase in the Government's Index of Retail Prices during the year ending in the preceding August. For the Group Section basis only, increases are capped at 5% per year. Deferred pensions have increased in accordance with the Scheme's Trust Deed and Rules.

Pensions in payment as at 30 September 2016 were increased on 1 October 2016 by 1.8% for the Plc section and 1.8% for the Group section (in line with RPI for the year to August 2016). Pensions in payment as at 30 September 2017 were increased on 1 October 2017 by 3.9% for the Plc section and 3.9% for the Group section (in line with RPI for the year to August 2017). There were no discretionary increases.

### 8. ADMINISTRATION AND INVESTMENT MANAGEMENT COSTS

The fees for professional services provided by the actuary, auditor, custodian, independent trustee, legal advisers, investment adviser and investment managers are all paid by the Scheme as well as the salary for the Scheme Secretary.

## **9. TRUSTEE GOVERNANCE MATTERS – RISK MANAGEMENT**

The Trustee has adopted and maintains a formal risk management process to assess risks and implement risk management strategies. This has involved identifying the type of risks the Scheme faces, presenting them in terms of potential impact and likelihood of occurrence and identifying means of mitigating the risks. As part of this process the Trustee has reviewed the adequacy of the Scheme's internal controls as documented in the Scheme's risk register.

## **10. SUMMARY FUNDING STATEMENT**

The Scheme provides members with an annual statement summarising the funding position under the Scheme. The next statement for the year ended 30 September 2017 will be sent to members in Spring 2018.

## **11. STATEMENT OF TRUSTEE'S RESPONSIBILITIES**

The financial statements, which are prepared in accordance with UK Generally Accepted Accounting Practice, are the responsibility of the Trustees. Pension scheme regulations require the Trustee to make available to Scheme members, beneficiaries and certain other parties, audited financial statements for each Scheme year which:

- Show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of that year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year,
- Are prepared on a going concern basis unless it is inappropriate to presume that the Scheme will not be wound up, and
- Contain the information specified in regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement whether the financial statements have been prepared in accordance with the Statement of Recommended Practice "Financial Reports of Pension Schemes".

The Trustee has supervised the preparation of the financial statements and has agreed suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an Annual Report.

The Trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme and the dates on or before which such contributions are to be paid. The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

## BAA Pension Scheme Trustee's Report

### 12. INVESTMENT STRATEGY

The Trustee sets the investment strategy for the Scheme, taking into account considerations such as the strength of the Employer covenant, the long-term liabilities of the Scheme and the funding agreed with the Employer. The investment strategy is set out in the Scheme's Statement of Investment Principles ("SIP") and Investment Policy Implementation Document ("IPID").

The current strategy is broadly split between:

1. Investments that move in line with the long-term liabilities of the Scheme. This is referred to as Liability Driven Investing ("LDI"), which comprises mostly UK government bonds ("Gilts"), Gilt repurchase agreements and cash, along with interest rate swaps and inflation swaps to a lesser extent. The purpose of these investments is to hedge against the impact of interest rate and inflation movements on the value of the long-term liabilities.
2. Return-seeking investments comprising UK and overseas equities, UK and overseas non-government bonds, property, multi-strategy funds and hedge funds. The purpose of these investments is to deliver a relatively high return in a diversified and risk-controlled manner to remain within the Scheme's risk budget of 6% Funding-Ratio-at-Risk (i.e. the Scheme's investment strategy should not risk the funding ratio falling by more than 6% in a 1-in-20 downside scenario on a prudent Self-Sufficiency basis).

Over the course of the year, a number of changes were made to the investment strategy:

- **Rogge** – changes were made to the Rogge mandate to make it easier for the manager to achieve the target return and reduce fees.
- **Wellington** – the target return of this mandate was increased from LIBOR + 1-1.5% to LIBOR + 3-4% without increasing base fees.
- **BlackRock LDI** – the Scheme's liability-hedging mandate was transitioned from Rogge to BlackRock and the interest rate and inflation hedge ratios increased to be broadly in line with the Self-Sufficiency funding ratio. A number of changes were subsequently made to the BlackRock mandate to increase hedge accuracy and reduce costs of leverage used by the LDI portfolio.
- **Brevan Howard** – a full redemption was instructed in August 2016 and the Scheme has been receiving these redemption payments of c.£29m on a quarterly basis, with the first being received at the end of March 2017 and the last in December 2017.

The table below shows the Scheme's investment manager structure as at 30 September 2017:

Asset Class	Manager
<b>Equities</b>	State Street Global Equity
<b>Credit</b>	BlackRock Corporate Bonds
	BlueBay Global Multi-Asset Credit
	Rogge LIBOR+
	Wellington LIBOR+
<b>Property</b>	M&G Long Leases
<b>Macro Orientated</b>	Brevan Howard
	Winton
<b>Multi Strategy</b>	Invesco
<b>Liability Hedging</b>	BlackRock LDI
	JPM Liquidity Fund (cash)

## BAA Pension Scheme Trustee's Report

Investment in stock, shares, debentures or other securities issued by Grupo Ferrovial SA, any holding company of Grupo Ferrovial SA or any subsidiary of Grupo Ferrovial SA or any such holding company is restricted under the terms of the investment manager agreements in place. The Trustee accepts that where they invest in pooled investment vehicles, the Trustee cannot impose this restriction on the investment manager.

### 13. ASSET ALLOCATION

The table below shows the Scheme's investment allocation as at 30 September 2017 versus last year's asset allocation and target strategic allocation:

	30 September 2017	30 September 2016	Target asset allocation <sup>(1)</sup>
Equity	10.5%	8.6%	10.2%
Credit	14.0%	12.9%	13.8% <sup>(3)</sup>
Property	3.2%	2.9%	3.2%
Macro Orientated/ Multi Strategy	17.2%	17.9%	17.1% <sup>(2)</sup>
LIBOR+	16.3%	15.4%	7.6%
Illiquid Credit	0%	0%	8.6% <sup>(3)</sup>
Liability Hedging Assets & Cash <sup>(4)</sup>	38.9%	42.3%	39.5%

(1) Based on the ISC's decision at the 20 June 2017 meeting to invest in diversified risk premia, opportunistic illiquid credit and diversified matching illiquids.

(2) Includes the allocation to diversified risk premia

(3) includes the allocation to opportunistic illiquid credit and diversified matching illiquids

(4) Includes liability-hedging interest rate and inflation swaps, gilts, cash and residual balance in legacy portfolios.

Figures subject to rounding

As mentioned in section 3 (changes after year end), the Scheme conducted a review of the strategic asset allocation in 2017 and, at the June Investment Sub Committee meeting, decided to invest in Diversified Risk Premia, Opportunistic Illiquid Credit and Diversified Matching Illiquids. As such, the 'target asset allocation' shown in the table above represents the asset allocation once these changes have been implemented.

A Statement of Investment Principles (SIP), which reflects the Trustee's investment approach, has been produced and is periodically reviewed and updated.

### 14. INVESTMENT PERFORMANCE

The table below shows the Scheme's return over various periods to 30 September 2017.

	1 Year	3 Years (p.a.)	5 Years (p.a.)
Scheme	-2.1%	9.6%	9.7%
Change in value of liabilities*	-3.1%	11.6%	11.0%

\*Change in liabilities has been calculated on a Gilts basis by the Actuary and the asset return uses performance data estimated by Cardano and Redington.

As the most appropriate overall benchmark for the investment strategy, the Scheme uses an approximation for the movement in the value of its liabilities through time. Adopting this benchmark means that over certain periods there may be significant discrepancies between this benchmark and the underlying targets for each of the investment managers used. This is because strategic decisions have been taken with a long-term view, and individual investment managers are therefore not intended to exactly match a liability-based benchmark.

**15. INVESTMENT MANAGER FEES**

All of the investment managers are remunerated on an ad valorem basis, i.e. fees are calculated based on the market value of the assets under their management. There are however additional performance-related fees in place for Winton and Wellington.

**16. INVESTMENT POLICY**

The Trustee makes all major decisions on the management of assets and liabilities based on investment advice. There is also an Investment Sub-Committee that has limited powers to make certain decisions as agreed and delegated by the Trustee. The Investment Sub-Committee also receives investment advice before taking decisions.

The Trustee has clear investment objectives, which relate to improving the value of the assets compared to the liabilities. They also monitor the risk versus the liabilities, based on information supplied by their investment advisor. Performance is measured against the Trustee's liability-related benchmark each quarter, as well as underlying manager performance being reviewed on a quarterly basis against their respective benchmarks.

The Trustee's Statement of Investment Principles (SIP) sets out its policy on Responsible Ownership. The Trustee's policy is that its Investment Managers should take account of social, environmental and ethical considerations in the selection, retention and realisation of investments to the extent material to the value of the investments, and where to do so would not prejudice the best long-term financial interests of the Scheme, more generally. With regard to corporate governance, the Trustee wishes to encourage best practice in terms of activism. It therefore encourages its managers investing in equities to discharge their responsibilities in respect of investee companies in accordance with the Statement drawn up by the Institutional Shareholders' Committee.

The global custodian, JP Morgan, is responsible for the safekeeping of the Scheme's directly held assets and performs the associated administrative duties.

The Trustee communicates periodically with members on investment issues as part of their regular member updates. In particular, the SIP is reviewed periodically and is available to all members on request.

Signed on behalf of BAA Pension Trust Company Limited:

Director

Director

Date: 26 April 2018...

The Compliance Statement on pages 38 to 39 forms part of this Trustee's Report.

## **Independent Auditor's Report to the Trustee of the BAA Pension Scheme**

### **Opinion**

We have audited the financial statements of the BAA Pension Scheme for the year ended 30 September 2017 which comprise the Fund Account, the Statement of Net Assets and the related notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 - The Financial Reporting Standard applicable in the UK and Republic of Ireland (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 30 September 2017, and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the year;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- contain the information specified in Regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Scheme in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Conclusions relating to going concern**

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Trustee's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Trustee has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Scheme's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

### **Other information**

The Trustee is responsible for other information comprising the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact

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**Independent Auditor's Report for the year ended 30 September 2017**

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We have nothing to report in this regard.

**Responsibilities of the Trustee**

As explained more fully in the statement of Trustee's responsibilities, the Trustee is responsible for the preparation of the financial statements, for being satisfied that they give a true and fair view, and for such internal control as the Trustee determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Trustee is responsible for assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Trustee either intends to wind up the Scheme or has no realistic alternative but to do so.

**Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

**Use of our report**

This report is made solely to the Trustee, as a body, in accordance with The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Trustee those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme and the Trustee as a body, for our audit work, for this report, or for the opinion we have formed.

**Crowe Clark Whitehill LLP**

Statutory Auditor

London

Date: 30 April 2018

**BAA Pension Scheme**  
**Fund Account for the year ended 30 September 2017**

	Note	2017	2016
		£'000	£'000
<b>Contributions and benefits</b>			
Contributions receivable	3		
Employer		51,075	64,456
Employee		5,196	5,501
Transfers in	4	244	156
		<u>56,515</u>	<u>70,113</u>
Benefits paid or payable	5	95,951	96,136
Payments to and on account of leavers	6	102	18
Individual transfers out to other plans		21,934	8,017
Administrative expenses	7	2,808	2,610
		<u>120,795</u>	<u>106,781</u>
<b>Net withdrawals from dealings with members</b>		<u>(64,280)</u>	<u>(36,668)</u>
<b>Return on investments</b>			
Investment income	8	78,882	43,286
Investment management expenses	9	(6,615)	(5,507)
Change in market value of investments	10	(152,865)	724,926
<b>Net returns on investments</b>		<u>(80,598)</u>	<u>762,705</u>
<b>Net (decrease)/ increase in the fund during the year</b>		<u>(144,878)</u>	<u>726,037</u>
<b>Net assets of the Scheme at 1 October</b>		<u>4,063,556</u>	<u>3,337,519</u>
<b>Net assets of the Scheme at 30 September</b>		<u>3,918,678</u>	<u>4,063,556</u>

The notes on pages 16 to 35 form part of these financial statements



**BAA Pension Scheme**  
**Statement of Net Assets (available for benefits) as at 30 September 2017**

	Note	2017 £'000	2016 £'000
<b>Investment assets</b>			
Bonds	12	3,318,012	2,027,785
Pooled Investment vehicles	13	1,523,829	1,487,894
Derivatives	14	228,542	1,127,155
AVC Investments	15	1,333	1,321
Other investment balances	16	423,898	124,996
		<u>5,495,614</u>	<u>4,769,151</u>
<b>Investment liabilities</b>			
Derivatives	14	(134,321)	(510,097)
Other investment balances	16	(1,455,863)	(203,982)
		<u>(1,590,184)</u>	<u>(714,079)</u>
<b>Total net investments</b>		3,905,430	4,055,072
Current assets	20	18,792	12,494
Current liabilities	21	(5,544)	(4,010)
<b>Total net assets as at 30 September</b>		<u><b>3,918,678</b></u>	<u><b>4,063,556</b></u>

The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which does take account of such obligations, is dealt with in the Report on Actuarial Liabilities on page 6 of the Trustee's Report and these financial statements should be read in conjunction with this report.

The financial statements were approved by the Directors of BAA Pension Trust Company Ltd on

26 April 2018

\_\_\_\_\_  
 Director

\_\_\_\_\_  
 Director

The notes on pages 16 to 35 form part of these financial statements

## **1. BASIS OF PREPARATION**

The financial statements have been prepared on a going concern basis in accordance with the Occupational Pension Plans (Requirements to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 ("FRS 102") – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and the guidance set out in the Statement of Recommended Practice (Revised November 2014) ("the Revised SORP").

In March 2016, an amendment was made to FRS 102 revising the fair value disclosure requirements for Pension Schemes. This amendment applies for accounting periods beginning on or after 1 January 2017. Early adoption is permitted, however for periods ending 31 December 2015 onwards. The Trustee has decided to adopt the amended disclosure early as set out in these financial statements at Note 18 – "Fair value determination".

## **2. ACCOUNTING POLICIES**

The principal accounting policies adopted by the Trustee are shown below:

### **a) Contributions**

- (i) Employee contributions, including AVCs and added years, are accounted for by the Trustee when they are deducted from pay by the Employer.
- (ii) Employer normal contributions that are expressed as a rate of salary are accounted for on the same basis as the employees' contributions, in accordance with the Schedule of Contributions in force during the year.
- (iii) Augmentation contributions are paid from time to time by the employer to fund benefit improvements on the terms agreed with the Trustee. These are accounted for on an accruals basis.
- (iv) Deficit contributions are accounted for on the due dates on which they are payable in accordance with the Schedule of Contributions under which they are paid.

### **b) Transfers in**

Transfers in from other registered pension arrangements include all transfers which have been formally accepted by the Trustee of the Scheme as at 30 September in respect of individual members.

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

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**2. ACCOUNTING POLICIES (continued)**

c) Benefits Payable and Payments to Leavers

- (i) Pensions in payment are accounted for in the period to which they relate.
- (ii) Benefits are accounted for in the period in which the member notifies the Trustee of their decision on the type or amount of benefit to be taken, or if there is no member choice, on the date of retiring or leaving.
- (iii) Individual transfers out are accounted for on a cash basis and represent the capital sums paid to personal pensions or pension plans of new employers for members who have left service. Group transfers are recognised in accordance with the transfer agreement.

d) Expenses

Administration and investment management expenses are accounted for on an accruals basis.

e) Investment Income

- (i) Investment income from bonds is recognised on an accruals basis.
- (ii) Dividend income from equity shares is recognised when the Scheme becomes entitled to the dividend. In the case of UK quoted shares this will be from the ex-dividend date.
- (iii) Income from accumulating pooled investment vehicles is reinvested by the fund managers and is included within change in market value.
- (iv) Deposit and other income receivable is accounted for on an accruals basis.

f) Change in market value of investments

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on the sale of investments during the year.

## **2. ACCOUNTING POLICIES (continued)**

### **g) Investments**

#### **(i) Investments other than derivatives**

- Listed securities are valued at bid price as at the year end date.
- Pooled investment vehicles are valued at the bid market values at the year end date for funds with bid/offer spreads, or a single price where there are no bid/offer spreads, as provided by the relevant fund managers on the last dealing day prior to the year-end date.
- The Macro Orientated Funds disclosed within pooled investment vehicles are valued at fair value either using a swinging single price or the net asset value at the year-end.
- Investments held in foreign currencies are valued as above and translated into sterling at the relevant spot rates ruling at the year-end date.
- Investments are included in the financial statements at fair value. In the absence of a liquid market for certain securities, these fair values may differ from their realisable value.

#### **(ii) Derivatives**

##### **Futures**

- Open futures contracts that are exchange traded are included in the net asset statement at market value. For futures contracts that are assets, market value will be unrealised profit at the quoted bid price of the contract at the year end. For futures contracts that are liabilities, market value will be the unrealised loss at the quoted offer price of the contract at the year end.
- Amounts due to or from brokers are included within cash deposits and other investment balances and represent the amounts outstanding in respect of the initial margin (representing collateral on the contracts) and any variation margin which is due to or from the broker.
- The amounts included in change in market value are the realised and unrealised gains or losses on open and closed futures contracts.

#### **(iii) Swaps**

- Swaps are 'Over the Counter' (OTC) derivatives and are included in the net asset statement at market value using pricing models and relevant market data at the year-end date.
- Interest is accrued monthly on a basis consistent with the terms of each contract. The amounts included in change in market value are the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts.
- Interest receipts or payments on swap contracts are reported within investment income.
- All gains and losses arising on these contracts are included within change in market value.

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

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## **2. ACCOUNTING POLICIES (continued)**

### **(iv) Options**

- All option derivatives utilised by the Scheme are exchange traded and are included in the net asset statement at their mark to market value.
- Options contracts are entered to hedge risk exposures and all gains or losses arising on open and closed contracts are included within change in market value.

### **(v) Bond Forwards**

- Bond forward contracts are included in the net asset statement at their mark to market value. All gains or losses arising on open and closed contracts are included within change in market value.

### **(vi) Forward Foreign Exchange**

- Forward foreign exchange contracts outstanding at the year-end are stated at fair value which is determined as the gain or loss that would arise if the outstanding contract was closed out at the year-end date with an equal and opposite contract.
- All gains or losses arising on these contracts are included within change in market value.

### **(vii) Repurchase Agreements**

- Bond investments are sold subject to contractual agreements ('Repurchase Agreements') for the repurchase of equivalent securities. The securities sold are stated at bid prices where available and accounted for within their respective investment classes. The contracts to buy back the equivalent securities, the Repurchase Agreements, are an investment liability and amounts payable under the repurchase agreements are stated at the value of contracted obligation.
- Bond investments are bought subject to contractual agreements ('Reverse Repurchase Agreements') for the resale of equivalent securities. The securities bought are excluded from their respective investment classes. The contracts to sell back the equivalent securities, the Reverse Repurchase Agreements, are an investment asset and the Market Value reported is the cash paid to the counterparty at inception of the Agreements.

### **h) Currency**

The Scheme's functional and presentational currency is pounds Sterling (GBP).

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

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**3. CONTRIBUTIONS RECEIVABLE**

	<b>2017</b>	<b>2016</b>
	<b>£'000</b>	<b>£'000</b>
Employer		
Normal - future service	26,954	37,440
Augmentations	1,121	1,016
Deficit funding	23,000	26,000
	<u>51,075</u>	<u>64,456</u>
Employee		
Normal	5,050	5,345
Additional voluntary contributions	25	26
Additional contributions to purchase added years	121	130
	<u>5,196</u>	<u>5,501</u>
	<u>56,271</u>	<u>69,957</u>

Augmentations include £1.034m (2016: £1.016m) in respect of the reimbursement by the Employer of discretionary Unfunded Unapproved Retirement Benefits schemes (UURBS) pensions paid by the Scheme and included in pensions payable in note 5.

Deficit funding contributions are payable by the Employer until 30 September 2022 in accordance with the Recovery Plan agreed with the Trustee. Until 30 June 2016 £27m p.a. was payable in monthly installments and from 1 July 2016 £23m p.a. was payable also in monthly instalments.

**4. TRANSFERS IN**

	<b>2017</b>	<b>2016</b>
	<b>£'000</b>	<b>£'000</b>
Individual transfers in from other schemes	<u>244</u>	<u>156</u>

**5. BENEFITS PAID OR PAYABLE**

	<b>2017</b>	<b>2016</b>
	<b>£'000</b>	<b>£'000</b>
Pensions	89,493	87,469
Lump sum death benefits	157	513
Commutations and lump sum retirement benefits	6,301	8,145
Taxation on lifetime or annual allowance exceeded	-	9
	<u>95,951</u>	<u>96,136</u>

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**6. PAYMENTS TO AND ON ACCOUNT OF LEAVERS**

	<b>2017</b> <b>£'000</b>	<b>2016</b> <b>£'000</b>
Refund on leaving	1	11
Refund on death	94	13
State scheme premium	7	(6)
	<u>102</u>	<u>18</u>

Included within the 2016 State scheme premium expense is the release of a prior year over accrual of £6k.

**7. ADMINISTRATIVE EXPENSES**

	<b>2017</b> <b>£'000</b>	<b>2016</b> <b>£'000</b>
Actuarial fees	389	528
Legal and professional fees	499	328
Investment adviser fees	699	573
Independent Trustee fees	99	50
PPF levy and other regulatory levies	180	388
Audit fee	70	68
Scheme administrative costs	872	675
	<u>2,808</u>	<u>2,610</u>

**8. INVESTMENT INCOME**

	<b>2017</b> <b>£'000</b>	<b>2016</b> <b>£'000</b>
Dividends from equities	31	90
Income from bonds	44,503	34,450
Income from pooled investment vehicles	4,756	4,609
Interest receivable on swap contracts	49,153	13,898
Interest payable on swap contracts	(17,189)	(9,585)
Interest on cash deposits	9	27
Net interest on cash instruments	(2,413)	(244)
Income from stock lending	32	41
	<u>78,882</u>	<u>43,286</u>

Income from pooled investment vehicles principally consists of distributions from the M&G property fund £4,725k (2016: £4,557k).

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**9. INVESTMENT MANAGEMENT EXPENSES**

	2017 £'000	2016 £'000
Administration, management and custody	6,673	5,562
Investment managers fee rebate	(58)	(55)
	<u>6,615</u>	<u>5,507</u>

Included within investment management expenses is irrecoverable VAT amounting to £387k (2016: £403k).

**10. RECONCILIATION OF INVESTMENTS**

	Value at 30 September 2016 £'000	Purchases at cost and derivative payments £'000	Sales proceeds and derivative receipts £'000	Change in Market Value £'000	Value at 30 September 2017 £'000
Bonds	2,027,785	5,566,866	(4,171,183)	(105,456)	3,318,012
Pooled investment vehicles	1,487,894	248,597	(304,388)	91,726	1,523,829
Derivative contracts	617,058	313,171	(702,687)	(133,321)	94,221
AVC investments	1,321	25	(84)	71	1,333
	<u>4,134,058</u>	<u>6,128,659</u>	<u>(5,178,342)</u>	(146,980)	4,937,395
Cash deposits & other investment balances	(78,986)			(5,885)	(1,031,965)
	<u>4,055,072</u>			<u>(152,865)</u>	<u>3,905,430</u>

Indirect costs are incurred through the bid offer spread on investments within pooled investment vehicles and charges made within those vehicles.

During the year the Trustee transferred the liability hedging portfolio from Rogge to BlackRock. Purchases and sales include bonds that were transferred in-specie amounting to £888.2m.

Transaction costs are included in the cost of purchases and deducted from the sale proceeds. Direct transaction costs include costs charged to the Scheme such as fees, commissions and stamp duty.

There were no separately identifiable direct transaction costs during the year (2016: £457k) based on global custodian records.



**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

### 11. Concentration of investments

Except as noted below, no investments represented more than 5% of the Scheme's assets.

<b>Holding</b>	<b>2017 £'000</b>	<b>2017 %</b>	<b>2016 £'000</b>	<b>2016 %</b>
Invesco Global Targeted Returns Fund	383,530	9.8	374,450	9.2
BlueBay Global Multi Asset Credit Fund	294,729	7.5	277,318	6.8
State Street MPF North America Equity 75Pct Hedged	245,434	6.3	210,639	5.2
Winton Futures Fund	228,206	5.8	234,516	5.8

### 12. Bonds

	<b>2017 £'000</b>	<b>2016 £'000</b>
<b>Bonds</b>		
Fixed interest securities	1,574,410	1,054,280
Index linked securities	1,743,602	973,505
<b>Total Bonds</b>	<b>3,318,012</b>	<b>2,027,785</b>

### 13. Pooled investment vehicles

Equity funds	408,418	347,754
Credit funds	318,776	298,672
Property fund	126,693	117,590
Macro orientated funds	286,412	349,428
Multi strategy fund	383,530	374,450
<b>Total pooled investment vehicles</b>	<b>1,523,829</b>	<b>1,487,894</b>

The underlying assets in the Credit funds consist primarily of higher yielding fixed income securities.

Macro (Global) orientated funds primarily contain global equity, bond, commodity and currency derivatives.

Multi strategy funds contain a range of asset classes with different characteristics, predominantly UK and overseas equities, currencies, and derivatives.

		<b>2017 £'000</b>		<b>2016 £'000</b>	
<b>14. Derivative contracts</b>		Assets	Liabilities	Assets	Liabilities
Futures	14(a)	1,856	(4,574)	111	(376)
Forward foreign exchange contracts	14(b)	29,257	(9,585)	9,960	(17,632)
Swaps	14(c)	197,105	(120,005)	1,116,851	(491,842)
Options	14(d)	99	(12)	222	(165)
Bond forwards	14(e)	225	(145)	11	(82)
		<b>228,542</b>	<b>(134,321)</b>	<b>1,127,155</b>	<b>(510,097)</b>

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

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**14(a) Futures**

The Scheme manages risk in the portfolio by entering into a futures position to adjust the portfolio weighting without disturbing the underlying assets.

Futures contracts are exchange traded derivatives, which reduces the risk that the counterparty does not fulfill their side of the contract.

Open futures contracts at the year-end, all of which expire within one year are as follows:

<b>Nature</b>	<b>Economic Exposure Value (asset)</b>	<b>Economic Exposure Value (liability)</b>	<b>Market Value (asset)</b>	<b>Market Value (liability)</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
UK Bonds	146,178	(30,351)	200	(3,404)
Overseas Bonds	99,704	(463,847)	1,615	(1,167)
UK Equity	4,600	-	-	(3)
Overseas Equity	-	(47,533)	41	-
<b>Total</b>	<b>250,482</b>	<b>(541,731)</b>	<b>1,856</b>	<b>(4,574)</b>

**Expiration**

<b>30 September 2017</b>	<b>250,482</b>	<b>(541,731)</b>	<b>1,856</b>	<b>(4,574)</b>
30 September 2016	42,086	(281,978)	111	(376)

The economic exposure values futures on a 'gross basis' showing the total exposure to the underlying asset class that the future effects as if the change in asset allocation in the underlying asset has taken place.

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**14(b) Forward Foreign Exchange Contracts**

During the period forward foreign exchange contracts were entered into by the Scheme to hedge foreign exchange risk on overseas securities.

Forward contracts are individually traded over-the-counter contracts. The contracts are generally three months duration.

Open forward foreign exchange contracts at the year-end are as follows:

Country of currency underlying forward foreign exchange contracts	Gross amount at inception (asset) £'000	Gross amount at inception (liability) £'000	Market Value (asset) £'000	Market Value (liability) £'000
USA	492,156	(1,092,218)	19,645	(4,348)
Europe	127,733	(295,786)	6,541	(1,152)
Japan	6,644	(10,775)	159	(175)
Others	208,234	(161,147)	2,912	(3,910)
<b>30 September 2017</b>	<b>834,767</b>	<b>(1,559,926)</b>	<b>29,257</b>	<b>(9,585)</b>
30 September 2016	976,689	(1,651,277)	9,960	(17,632)

The gross amount is the gross sterling equivalent of the currency on which the contract is based.

**14(c) Swaps**

The Scheme has entered into a series of interest rate, inflation and total return primarily to hedge against long term interest rate and inflation rate movements.

Swap contracts in place as at 30 September 2017 are as follows:

Expiration	Nominal Principal £'000	Market Value (asset) £'000	Market Value (liability) £'000
Up to 2020	472,496	15,985	(13,423)
2021 to 2030	1,074,475	25,525	(41,187)
After 2030	429,946	155,595	(65,395)
<b>30 September 2017</b>	<b>1,976,917</b>	<b>197,105</b>	<b>(120,005)</b>
30 September 2016	3,306,500	1,116,851	(491,842)

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**14(c) Swaps (continued)**

Types of swaps	Nominal Principal £'000	Market Value (asset) £'000	Market Value (liability) £'000
Interest rate	1,176,112	180,416	(90,233)
Inflation	375,705	1,026	(16,349)
Total return	425,100	15,663	(13,423)
<b>30 September 2017</b>	<b>1,976,917</b>	<b>197,105</b>	<b>(120,005)</b>
30 September 2016	3,306,500	1,116,851	(491,842)

The notional principal of the swap is the amount used to determine the value of swapped receipts and payments.

To reduce counterparty risk during the life of the swap collateral in the form of cash or government bonds is passed between the parties depending on whether there is an asset or a liability and the value of the swap. See note 14(f).

**14(d) Options**

The Scheme enters into option contracts to meet the requirements of its risk management activities. These option contracts are exchange traded and the exchange acts as the counterparty, bearing the risk of failure to deliver the position. All contracts expire within one year.

Investment underlying option Contract	Nominal amount of contract £'000	Market value (asset) £'000	Market value (liability) £'000
Overseas bonds purchased - Puts	8,909	24	-
Overseas bonds purchased - Calls	5,630	75	-
Overseas bonds written – Calls	1,740	-	(12)
<b>30 September 2017</b>	<b>16,279</b>	<b>99</b>	<b>(12)</b>
30 September 2016	99,100	222	(165)

The notional amount represents the value of underlying stocks subject to the option contracts. Included in options are swaptions with a value of £29,871 (2016: £29,300).

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**14(e) Bond Forward Contracts**

Bond forwards are over the counter contracts entered into by two counterparties to buy or sell a bond on a specified future date at an agreed price. The contracts generally expire in up to three months.

	<b>Gross amount at inception (asset)</b>	<b>Gross amount at inception (liability)</b>	<b>Market value (asset)</b>	<b>Market value (liability)</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Overseas	107,335	-	225	(145)
<b>Total 30 September 2017</b>	<b>107,335</b>	<b>-</b>	<b>225</b>	<b>(145)</b>
30 September 2016	17,287	(28,467)	11	(82)

**14(f) Collateral**

During the year collateral was received and pledged in respect of non-centrally cleared swaps, bond forward contracts and repurchase agreements. At the year end the collateral received/pledged was as follows:

	<b>2017 £'000</b>	<b>2016 £'000</b>
<b>Collateral Received</b>		
Stock equivalents	4,394	283,977
Cash equivalents	90,130	454,891
	<u>94,524</u>	<u>738,868</u>
<b>Collateral Pledged</b>	<b>£'000</b>	<b>£'000</b>
Stock equivalents	(76,806)	(83,418)
Cash equivalents	(37,516)	-
	<u>(114,322)</u>	<u>(83,418)</u>

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

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**14(g) Stock Lending**

During the year the Fund lent some of its investments under a stock lending agreement. The titles to the investments that have been lent remain with the Fund and dividends paid during the year in respect of stock lent by the Fund are paid to the Fund. Collateral is received by the Fund in excess of the market value of the stock lent. At 30 September 2017 the position was as follows:

	<b>2017</b> <b>£'000</b>	<b>2016</b> <b>£'000</b>
<b>Stock Lending</b>		
Bonds	-	10,941
<b>Collateral</b>	<b>£'000</b>	<b>£'000</b>
Bonds	-	6,018
Cash equivalents	-	5,282
	-	11,300
	<b>£'000</b>	<b>£'000</b>
Income for the year (note 8)	32	54

**15. AVC investments**

	<b>2017</b> <b>£'000</b>	<b>2016</b> <b>£'000</b>
Santander	263	269
Equitable Life Insurance	133	125
Friends Life	937	927
	1,333	1,321

AVC investments held on a money purchase basis are invested separately from main Scheme assets. Members participating in such AVC arrangements each receive an annual statement confirming the value of their investments and the movement in the year.

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

	<b>2017</b>		<b>2016</b>	
	<b>£'000</b>		<b>£'000</b>	
<b>16. Cash deposits and other investment balances</b>	Investment Assets	Investment Liabilities	Investment Assets	Investment Liabilities
Repurchase agreements	316,386	(1,428,740)	-	(20,175)
Investment income receivable	11,084	-	10,481	-
Cash deposits and liquidity funds	10,484	-	64,474	-
Short term investments	76,493	-	44,604	-
Amounts due under rehypothecation	-	-	-	(175,000)
Cash due to/from Broker	7,279	(18)	1,437	-
Outstanding trades	2,172	(27,105)	4,000	(8,807)
	<b>423,898</b>	<b>(1,455,863)</b>	<b>124,996</b>	<b>(203,982)</b>

The Scheme instigated a collateral rehypothecation programme over the course of the prior year. This programme allowed the Scheme to reduce its ongoing funding costs within its LDI portfolio managed by Rogge, by using some of the cash collateral posted to it for "in-the-money" derivative positions to reduce the amount of borrowing required on Repurchase Agreements and Total Return Swaps that was needed to achieve the target rate of exposure within the LDI portfolio. The programme was subsequently unwound after year-end, in preparation for the transition of assets to the Scheme's newly appointed LDI manager, BlackRock.

#### **17. Repurchase Agreements**

The Scheme holds an interest rate and inflation hedging mandate under which bonds have been sold subject to repurchase agreements and reverse repurchase agreements.

Under repurchase agreements the Scheme retains the entitlement to receive income accruing on these securities and has a contractual agreement to repurchase the securities at a specified future date. The securities are included in the financial statements as assets of the Scheme at their market value. At 30 September 2017 the market value of securities included was £1,430.88m (2016: £20.52m).

Cash received from counterparties in respect of the securities that have been sold is used by the investment manager to purchase additional securities to meet desired exposure levels. Amounts payable to counterparties under repurchase agreements are disclosed as liabilities in the Scheme's financial statements under other investment liabilities.

Under reverse repurchase agreements, the financial statements recognise the cash delivered to the counterparty as an asset.

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**18. Fair value determination**

The fair value of financial instruments has been determined using the following fair value hierarchy:

**Level 1:** The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

**Level 2:** Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

**Level 3:** Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

The Scheme's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
<b>At 30 September 2017</b>				
Bonds	2,555,366	762,646	-	3,318,012
Pooled investment vehicles	-	1,465,623	58,206	1,523,829
Derivatives	(2,718)	96,939	-	94,221
AVC investments	-	50	1,283	1,333
Cash deposits & other investment balances	(1,031,965)	-	-	(1,031,965)
	1,520,683	2,325,258	59,489	3,905,430
<b>At 30 September 2016</b>				
Bonds	1,254,181	773,604	-	2,027,785
Pooled investment vehicles	-	1,372,982	114,912	1,487,894
Derivatives	(265)	617,323	-	617,058
AVC investments	-	46	1,275	1,321
Cash deposits & other investment balances	(78,986)	-	-	(78,986)
	1,174,930	2,763,955	116,187	4,055,072



**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

## 19. Investment Risks

Financial Reporting Standards (FRS) 102 requires the disclosure of information in relation to certain investment risks. These risks are set out by FRS 102 as follows:

**Credit risk:** this is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

**Market risk:** this comprises currency risk, interest rate risk and other price risk as follows:

**Currency risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates;

**Interest rate risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates; and

**Other price risk:** this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Scheme has exposure to the above risks because of the investments it makes in following the investment strategy set out below. The Trustee manages investment risks within agreed risk limits, taking into account the Scheme's strategic investment objectives. These investment objectives and risk limits are implemented through the investment agreements in place with the Scheme's investment managers and they are monitored by the Trustee in regular reviews of the investment portfolio.

The following table summarises the extent to which the various classes of investments are affected by investment risks:

	Credit risk	Market risk			2017	2016
		Currency	Interest rate	Other price	£m	£m
<b>Liability Driven Investments</b>						
Bonds	●	○	●	●	2,555.4	1,240.2
Derivatives	●	●	●	●	73.1	625.4
Cash and Other investment assets and liabilities	●	●	●	○	-1,110.4	-181.6
<b>Return Seeking Investments</b>						
Bonds	●	●	●	○	762.6	787.6
Pooled investment vehicles	●	●	●	●	1,523.8	1,487.9
<i>Bond funds (direct and indirect risk)</i>					318.8	298.7
<i>Other funds (direct risk only)</i>					1,205.1	1,189.2
Derivatives	●	●	●	●	21.2	-8.4
Cash and Other investment assets and liabilities	●	●	●	○	78.4	102.6
<b>Total (excluding AVCs)</b>					<b>3,904.1</b>	<b>4,053.7</b>

In the above table, the risk noted affects the asset class [●] significantly, [●] partially or [○] hardly/not at all.

Further information on the Trustee's approach to risk management is set out below. This does not include AVC investments as these are not considered significant in relation to the overall investments of the Scheme.

### **Investment Strategy**

The Trustee determines investment strategy after taking advice from a professional investment adviser. The investment objective is to maintain a portfolio of suitable assets of appropriate liquidity which, together with future contributions, will generate investment returns to meet the benefits of the Scheme payable under the Trust Deed and Rules, as they fall due. Further details of the Trustee's investment strategy are set out in the Trustee's report on page 9.

### **Credit Risk**

The Scheme is subject to credit risk because it invests directly in bonds and over-the-counter ("OTC") derivatives and because it holds cash balances. The Scheme also invests in pooled investment vehicles and is therefore directly exposed to credit risk in relation to the instruments it holds in the pooled investment vehicles. In addition, the Scheme is indirectly exposed to credit risks arising from some of the financial instruments held by the pooled investment vehicles.

Credit risk arising from bonds held directly is mitigated by the appointment of investment managers with the appropriate skill and processes to manage these assets. These managers are also set limits and guidelines including restriction on the credit quality of the investment they purchase for the Scheme. These portfolios are very well diversified and the risk from any individual security or issuer is kept at an appropriate level given the credit worthiness of that security or issuer. For example, the Scheme may hold significant positions in UK Government Bonds as the credit risk associated with the UK Government is small.

Credit risk arising from OTC derivatives is mitigated by collateral arrangements (see note 14f).

Credit risk arising from cash balances is mitigated by transacting with governments and financial institutions which are investment grade credit rated.

Direct credit risk arising from pooled investment vehicles is mitigated by: the underlying assets of the pooled arrangements being ring-fenced from the pooled fund manager; the regulatory environments in which the pooled managers operate; diversification of the investments amongst a number of pooled arrangements; and due diligence checks carried out by the investment advisors appointed by the Trustee on the appointment of new pooled investment managers and on an ongoing basis thereafter.

Indirect credit risk arising from pooled investment vehicles is mitigated by the investment restrictions in place for each of the pooled investment vehicles, and varies depending on the nature of the underlying assets (see note 13).

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

A summary of exposures to credit risk at both the current and previous year end is given in the following tables:

2017				
	Investment Grade	Non- Investment Grade	Unrated	Total
	£m	£m	£m	£m
Bonds	3,313.2	4.9	-	3,318.0
Pooled investment vehicles	-	-	1,523.8	1,523.8
Derivatives	94.2	-	-	94.2
Cash and Other investment assets and liabilities	(1,032.0)	-	-	(1,032.0)
<b>Total (excluding AVCs)</b>	<b>2,375.4</b>	<b>4.9</b>	<b>1,523.8</b>	<b>3,904.1</b>

2016				
	Investment Grade	Non- Investment Grade	Unrated	Total
	£m	£m	£m	£m
Bonds	2,021.9	5.8	0.1	2,027.8
Pooled investment vehicles	-	-	1,487.9	1,487.9
Derivatives	617.0	-	-	617.0
Cash and Other investment assets and liabilities	(79.0)	-	-	(79.0)
<b>Total (excluding AVCs)</b>	<b>2,559.9</b>	<b>5.8</b>	<b>1,488.0</b>	<b>4,053.7</b>

### Currency Risk

The Scheme is subject to currency risk because some investment are denominated in overseas currencies.

A number of the managers hold bonds for the Scheme which are denominated in overseas currencies. The currency risk from the bonds is mitigated by the managers who use currency forwards to offset the majority of currency exposure. Any remaining exposure is held to achieve improved returns and the risk from these positions is carefully managed.

All pooled funds are reported in GBP so there is no direct currency risk from the pooled investment vehicles. Indirect currency risk from pooled investment vehicles is mitigated by investing in currency hedged share classes where available.

A summary of exposures to currency risk at both the current and previous year end is given in the following table:

2017	Investments	Currency Contracts	Total
	£m	£m	£m
US Dollar	606.0	(584.8)	21.2
Euro	127.6	(162.7)	(35.1)
Japanese Yen	0	(4.1)	(4.1)
Other overseas currency	0.5	46.0	46.5
<b>Total overseas exposure</b>	<b>734.1</b>	<b>(705.5)</b>	<b>28.5</b>
<b>Unhedged exposure (Total as % of Investments)</b>	<b>3.9%</b>		

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

2016	Investments	Currency Contracts	Total
	£m	£m	£m
US Dollar	594.6	(536.7)	57.9
Euro	136.3	(146.2)	(9.9)
Japanese Yen	26.4	(16.5)	9.9
Other overseas currency	17.9	0.4	18.3
<b>Total overseas exposure</b>	<b>775.2</b>	<b>(699.0)</b>	<b>76.2</b>
<b>Unhedged exposure %</b>	<b>9.8%</b>		

### Interest Rate Risk

The Scheme is subject to interest rate risk on the LDI investments, comprising government bonds, interest rate and inflation swaps and cash.

Interest rate risk is mitigated by aligning the sensitivity of the LDI investments with that of the Scheme's long term liabilities. Under this strategy, if interest rates fall the value of LDI investments will rise to match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise, the LDI investments will fall in value as will the actuarial liabilities because of an increase in the discount rate.

At the year-end the LDI portfolio represented 38.9% of the total assets (2016: 41.5%).

### Other Price Risk

The Scheme is subject to other price risk in relation to the return seeking investments which include equities, non-gilt bonds, property funds, diversified growth funds and hedge funds.

Other price risk is mitigated by constructing a diverse portfolio of investments across various markets and managers.

At the year-end these represented 61.1% of the total assets (2016: 58.5%).

**BAA Pension Scheme**  
**Notes to the Financial Statements for the year ended 30 September 2017**

**20. CURRENT ASSETS**

	2017 £'000	2016 £'000
<b>Debtors</b>		
Contributions due from the Principal Employer in respect of augmentations and UURBS pensions	86	84
Prepayments	20	31
Due from HMRC – VAT	77	58
	<u>183</u>	<u>173</u>
<b>Cash balances:</b>		
Cash at bank	18,609	12,321
	<u>18,792</u>	<u>12,494</u>

The contributions due from the Principal Employer as at 30 September 2017 were in respect of discretionary UURBS pensions paid by the Scheme and were received by the Scheme in accordance with the timescale set out in the Schedule of Contributions.

**21. CURRENT LIABILITIES**

	2017 £'000	2016 £'000
<b>Creditors</b>		
Administration and investment management expenses	3,790	2,345
Due to HMRC	1,180	1,162
State Scheme premiums payable	1	1
Benefits payable	573	502
	<u>5,544</u>	<u>4,010</u>

**22. RELATED PARTY TRANSACTIONS**

LHR Airports Ltd provides certain administration and other services to the Scheme. The costs of these services are recharged to the Scheme and are included within administrative expenses disclosed in Note 7. During the year these costs amounted to £120,000 (2016: £120,000). Independent Trustee fees are also disclosed in Note 7.

LHR Airports Ltd is responsible for certain discretionary payments of pension benefits. The actual payment of these amounts is made by the Scheme and reimbursed by LHR Airports Ltd. During the year such payments amounted to £1,033,904 (2016: £1,016,326). Apart from the above, and transactions and balances with the Principal Employer shown in the Financial Statements and notes thereto, there were no other related party transactions.

**23. CAPITAL COMMITMENTS**

At the year-end the Scheme had no capital commitments (2016: nil)

## **Independent auditor's statement about contributions to the Trustee of the BAA Pension Scheme**

### **Statement about contributions payable under the Schedule of Contributions**

We have examined the summary of contributions payable to the BAA Pension Scheme, for the Scheme year ended 30 September 2017 which is set out on page 37.

In our opinion contributions for the Scheme year ended 30 September 2017 as reported in the summary of contributions and payable under the Schedule of Contributions have in all material respects been paid at least in accordance with the Schedule of Contributions certified by the Scheme Actuary on 30 June 2016.

### **Basis of opinion**

Our objective is to obtain sufficient evidence to give reasonable assurance that contributions reported in the attached summary of contributions have in all material respects been paid at least in accordance with the Schedule of Contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the Schedule of Contributions.

### **Responsibilities of the Trustee**

As explained more fully in the Statement of Trustee's Responsibilities, the Scheme's Trustee is responsible for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions which sets out the rates and due dates of certain contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme. The Trustee is also responsible for keeping records in respect of contributions received in respect of active members of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the Schedule of Contributions.

### **Auditor's responsibilities for the statement about contributions**

It is our responsibility to provide a Statement about Contributions paid under the Schedule of Contributions and to report our opinion to you.

### **Use of our statement**

This statement is made solely to the Scheme's Trustee, as a body, in accordance with The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to them in an auditor's statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee as a body, for our work, for this statement, or for the opinion we have formed.

**Crowe Clark Whitehill LLP**  
Statutory Auditor  
London

Date: 30 April 2018

**BAA Pension Scheme**  
**Independent auditor's statement about contributions**

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**Trustee's summary of contributions payable during the Scheme year ended 30 September 2017**

Contributions payable to the Scheme in accordance with the Schedules of Contributions in respect of the year ended 30 September 2017 were as follows:

	<b>2017</b> <b>£'000</b>
Employer normal contributions	26,954
Employer deficit funding contributions	23,000
Employer augmentations	1,121
Member normal contributions	5,050
Total contributions paid under the Schedule of Contributions	<u>56,125</u>
Member additional voluntary contributions	25
Member additional contributions to purchase added years	121
Contributions disclosed in the financial statements	<u><u>56,271</u></u>

For and on behalf of the BAA Pension Trust Company Limited

\_\_\_\_\_  
 Director

\_\_\_\_\_  
 Director

Date: 26 April 2018

## BAA Pension Scheme Actuarial Certificates

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### CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS

Name of Scheme

BAA Pension Scheme

#### Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 30 September 2015 to be met by the end of the period specified in the recovery plan.

#### Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this schedule of contributions is consistent with the Statement of Funding Principles dated 29 June 2016.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

Signature

Scheme Actuary

Chris Sheppard

Qualification

Fellow of the Institute and Faculty of Actuaries

Date of signing

30/06/2016

Name of employer  
Address

Mercer Limited  
One Christchurch Way  
Woking  
Surrey  
GU21 6JG



INVESTORS  
IN PEOPLE

Mercer Limited is authorised and regulated by the Financial Conduct Authority  
Registered in England No. 981275 Registered Office: 1 Tower Place West,  
Tower Place, London EC3R 8BU



MARSH & MCLENNAN  
COMPANIES



**COMPLIANCE STATEMENT****1. Tax Status**

The Scheme was approved by the Inland Revenue Pension Schemes Office under Chapter 1 Part XIV of the Income and Corporation Taxes Act 1988 until 5 April 2007. Subsequently it became a Registered Scheme with Her Majesty's Revenue and Customs from 6 April 2007, in accordance with the provisions of the Finance Act 2006. The Trustee's opinion is that there is no reason to believe this approval/registration may be prejudiced or withdrawn.

**2. Employer Related Investments**

The Scheme did not hold any direct investments in the Employer during the year.

**3. Transfer of Pension Rights**

The Scheme can transfer pension rights to, or receive them from such schemes as are suitably approved by the Commissioners of Inland Revenue. Transfers out to other pension schemes include transfers to arrangements approvable under Section 32 of the Finance Act 1981. The sums transferred were cash equivalents calculated, and paid in the manner prescribed by the Actuary in accordance with legislation. The calculation of transfer values does not make any allowance for discretionary benefits as these are not a feature of the Scheme. Transfer values paid during the year are the full cash equivalent and have not been adjusted as a result of Scheme funding levels.

**4. Complaints**

If Scheme members have any queries concerning their benefits they should contact the Scheme's administrator at the address shown for enquiries on the contents page. If the enquiry is not resolved to their satisfaction, members should use the Scheme's dispute resolution procedure, which is aimed at resolving complaints and disputes.

The Pensions Advisory Service (TPAS), an independent voluntary organisation, offers free advice and assistance to members at any stage during the complaints process. The TPAS can be contacted at:

11 Belgrave Road  
London  
SW1V 1RB  
Tel: 0845 601 2923  
[www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)

If the matter remains unresolved after TPAS has assisted, members have the right to refer their complaint to the Pensions Ombudsman, who investigates complaints of injustice caused by bad administration or disputes of fact or law. The Pensions Ombudsman can be contacted at:

11 Belgrave Road  
London  
SW1V 1RB  
Tel: 0207 834 9144  
[www.pensions-ombudsman.org.uk](http://www.pensions-ombudsman.org.uk)

**COMPLIANCE STATEMENT (continued)**

**5. The Pensions Regulator**

The Pensions Regulator is the UK regulator of work-based pension schemes.

The Regulator's aim is to encourage high standards in the way pension schemes are run, to prevent problems from developing. The Regulator works with pension scheme trustees and scheme managers to help protect work-based pensions and if problems do develop, the Regulator has powers to put matters right. The Regulator cannot help with individual complaints or disputes, but if members believe that the Scheme is not complying with pensions rules and regulations, they can report this to the Regulator, at the following address:

Napier House  
Trafalgar Place  
Brighton  
BN1 4DW  
Tel: 0870 6063636  
[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)